

US ECONOMY CONTINUES TO PROSPER DESPITE GLOBAL FINANCIAL INSTABILITY

Over the last year, the US economy experienced another year of strong economic growth. The current economic expansion, which began in March 1991, is soon to surpass the previous expansion, which lasted from November 1982 to July 1990, and become the longest peacetime recovery. Economic performance, as measured by traditional indicators, posted several historic records over the last year.

- The unemployment rate has remained below 5 percent during every month since July 1997. This is the first time in 25 years that the unemployment rate has been that low.
- This low level of unemployment has not translated into higher prices within the economy. Inflation, as measured by changes in the Consumer Price Index (CPI), has been relatively stable, increasing by a little over 1½ percent over the last year. Except for one year, 1986, inflation has not been this low since the beginning of the 1960s.
- The “misery index,” which is a combination of the unemployment rate and changes in the CPI, is at its lowest level in over 30 years.
- The economy continued impressive job growth over the last year. Payroll employment grew by more than 3 million, almost twice the 40 year average of annual net job growth.
- After 20 years of stagnation, real average weekly earnings rose by 3½ percent over the last year, thereby representing an improvement in living standards for American workers.
- The improvement in wages was coupled with productivity gains of 2 percent in the non-farm business sector and 4 percent in the manufacturing sector. This recent pick-up in productivity growth has enabled workers to enjoy larger wage gains without putting upward

pressure on inflation.

- Over the last 4 years, real nonresidential fixed investment has been more than 10 percent of Gross Domestic Product (GDP). This investment grew by more than 13 percent just in the last year. Strong improvements in investment contributed to lifting productivity growth.
- A key domestic economic development over the past year was bringing the Federal budget into surplus for the first time in 40 years. This achievement was a result of policy changes — both reductions in government expenditures and increases in taxes — over the last decade. In addition, higher than expected tax revenues, due to the strong economy, brought the budget into surplus earlier than projected.

Although there is a lot to celebrate in the current economic expansion, there remain several areas of concern.

- Despite the fact that the national average unemployment rate is at an historic low, there remain significant pockets of high unemployment around the country. Between 15 and 20 percent of the more than 3,000 counties in the United States experienced unemployment rates above 8 percent during the first half for 1998.
- Economic prosperity in the United States over the last year occurred against the backdrop of global financial market instability and economic crises throughout the world. What began as a liquidity shortage in Thailand turned into a series of financial crises, spreading from East Asia to Russia and possibly Latin America. The consequences of these financial crises are just beginning to be felt in the United States.
- In the past, rising Federal budget deficits have diverted capital away from productive investment in the private sector. Although the Federal budget ended Fiscal Year 1998 in surplus, this improvement was more than offset by further declines in private

saving, due in part to the recent rise in wealth accumulation. The personal saving rate — the share of personal income which is not consumed — is now at an historic low level. This shortage of saving translates into insufficient resources available for robust domestic investment, thereby increasing the demand for foreign capital. This helps explain why real interest rates remain high, even as nominal interest rates continue to fall.

- The rising gap between domestic saving and investment is reflected in the worsening current account deficit. Despite strong domestic economic performance, the current account deficit grew by more than \$180 billion over the last year. This represents the largest deficit, in absolute terms, in US history.
- Improvements in the trade of services helped prevent a larger current account deficit. On the other hand, much of the increase in the deficit was concentrated in an increase in the merchandise trade deficit, which grew to close to \$135 billion over the same period. The financial crisis in East Asia and the strengthening of the US dollar against other major trading currencies, seriously weakened crucial US export markets abroad and reduced import prices domestically. As a result, US exports to the Pacific Rim countries dropped by 15 percent over the last year while imports from that region grew by 5 percent. The trade deficit is expected to further deteriorate over the next year, as the full impact of the global financial crisis begins to be felt.
- The initial impact of the financial and economic crises abroad on the US economy is already being felt and is expected to worsen over the next year. Economic growth is beginning to show some indication of weakening. US financial markets are already experiencing the insecurity being felt abroad. And deterioration of the trade deficit has already begun to place pressure on those workers employed in import-competing and export industries. The global financial and economic crisis is expected to have a significant impact on the distribution of jobs, income and wealth of American workers over the coming year.